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SUBJECT: SPECULATION ABOUT ADDITIONAL TAX MEASURES

1. SUMMARY. PRESS REPORTS ON NOVEMBER 27-28 SUGGEST THAT THERE MAY BE DEBATE GOING ON WITHIN GOI ABOUT NEED FOR ADDITIONAL TAX MEASURES BEYOND 5,000 BILLION LIRE PACKAGE ALREADY ANNOUNCED. ALTHOUGH FINANCE MINISTER PANDOLFI HAS STATED THAT GOVERNMENTIAL EFFORTS IN TAX FIELD ARE NOW COMPLETE, PRIME MINISTER ANDREOTTI STATED IN HIS NOVEMBER 10 STATEMENT TO PARLIAMENT THAT NEW EXPENDITURE PROGRAMS WOULD REQUIRE NEW REVENUES. TYPES OF TAX INCREASES BEING MENTIONED IN PRESS ARE INCOME TAX, VALUE ADDED TAX, NEW TAX AT MUNICIPAL GOVERNMENT LEVEL AND INCREASED SOCIAL INSURANCE CONTRIBUTIONS. END SUMMARY.

2. ADDITIONAL EXPENDITURES. MILAN'S "CORRIERE DELLA SERA" ON NOVEMBER 27 AND 28 CARRIED FRONT-PAGE ARTICLES BY DEMETRIO DE STEFANO SPECULATING ON NEED FOR TAX MEASURES ADDITIONAL TO PACKAGE
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OF 5,000 BILLION LIRE ALREADY ADOPTED OR PENDING. NOTWITHSTANDING

RECENT PUBLIC STATEMENTS BY MINISTER OF FINANCE PANDOLFI THAT GOI HAS NOW COMPLETED ITS TAX PACKAGE, "CORRIERE" POINTS OUT THAT INCREASING DEMANDS ON PUBLIC PURSE BOTH FOR NEW EXPENDITURE PROGRAMS AND FOR MEETING OLD UNRESOLVED AND PRESSING FINANCING NEEDS (E.G., HOSPITAL AND LOCAL GOVERNMENT DEBTS MAY MAKE ADDITIONAL TAXES INEVITABLE IF 1977 DEFICIT IS TO BE KEPT WITHIN BOUNDS. DE STEFANO NOTES THAT OF 5,000 BILLION LIRE REVENUE PACKAGE ABOUT 1,000 BILLION CONSISTS OF PUBLIC TARIFF MEASURES IN FAVOR OF ENEL, POSTAL SYSTEM AND STATE RAILROADS, SO THAT ONLY ABOUT 4,000 BILLION LIRE WOULD ACTUALLY BE AVAILABLE FOR CENTRAL GOVERNMENT EXPENDITURES. AT LEAST PART OF THIS FIGURE IS ALREADY EARMARKED FOR REDUCING TREASURY DEFICIT AND FOR FINANCING AGRICULTURE, YOUTH EMPLOYMENT AND RESIDENTIAL HOUSING PROPOSALS. "CORRIERE" SUGGESTS THAT ADDITIONAL FINANCING WILL BE NEEDED TO COVER REFORM OF LOCAL GOVERNMENT FINANCING, SALARY INCREASES IN PUBLIC ADMINISTRATION, GIOIA TAURO STEEL PLANT, FUNDS FOR STATE MINERAL AGENCY (EGAM) AND POSSIBLE CAPITAL INCREASE BY PARTIALLY STATE-OWNED MONTEDISON.

3. ADDITIONAL TAX MEASURES. "CORRIERE" MENTIONS POSSIBILITY OF INCOME TAX RATE INCREASES, NOTING, HOWEVER, THAT FINANCE MINISTER PANDOLFI AND EX-MINISTER OF FINANCE VISENTINI (REPUBLICAN PARTY) ARE BOTH OPPOSED. OPPOSITION OF PANDOLFI IS BASED ON BELIEF THAT FISCAL DRAG WILL ALREADY BOOST NOMINAL INCOMES INTO HIGHER BRACKETS IN 1977 AS RESULT OF INFLATION. VISENTINI HAS REPEATEDLY OBJECTED TO TAMPERING WITH INCOME TAX SYSTEMS, WHICH HAS ONLY RECENTLY BEEN SUBJECT TO COMPREHENSIVE REFORM. ON THE OTHER HAND, WELL-KNOWN UNIVERSITY ECONOMIST PAOLO SYLOS LABINI REPORTEDLY HAS PREPARED PROPOSAL FOR INCREASING PERSONAL INCOME TAX RATES FROM 13 TO 16 PERCENT IN 5 TO 6 MILLION LIRA INCOME CATEGORY AND FROM 16 TO 23 PERCENT IN 6 TO 8 MILLION LIRA CATEGORY, WITH HIGHER RATES PROPORTIONATELY INCREASED. DE STEFANO MENTIONS POSSIBILITY OF GRANTING MUNICIPAL GOVERNMENTS NEW TAXING AUTHORITY (PROBABLY PROPERTY TAX) IN CONNECTION WITH OVERALL REFORM OF LOCAL GOVERNMENT FINANCES. HE ALSO STATES THAT THERE ARE RUMORS THAT GOI MAY CONSIDER INCREASE IN SOCIAL INSURANCE CONTRIBUTIONS BY NON-WAGE AND SALARY WORKERS, E.G., BY SELF-EMPLOYED PERSONS IN COMMERCE AND HANDICRAFT INDUSTRIES. REPORTEDLY SUCH AN INCREASE WOULD PUT SUCH INCOME EARNERS MORE NEARLY ON A PAR WITH WAGE AND SALARY EARNERS. FINALLY, DE STEFANO REPORTS THAT DRAFT

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PROPOSAL FOR INCREASE IN VALUE ADDED TAX RATES (IVA) HAS BEEN DISTRIBUTED WITHIN GOI AND TO LABOR UNIONS IN CONNECTION WITH POSSIBLE FISCALIZATION OF PART OF SOCIAL INSURANCE COSTS PAID BY BUSINESS. SCHEME REPORTEDLY WOULD REDUCE SOCIAL INSURANCE COSTS AS SHARE OF BUSINESSES' LABOR COSTS FROM 41.5 PERCENT TO 26.5 PERCENT OF TOTAL. COST TO TREASURY WOULD BE ABOUT 3,000 BILLION LIRE. IVA DRAFT PROPOSAL WOULD REPORTEDLY MERGE PRESENT EIGHT IVA TAX RATES INTO FOUR TAX RATES WITH RESULTING

INCREASE IN TAX REVENUE OF MORE THAN 3,000 BILLION LIRE ON ANNUAL BASIS (SEE BELOW).

4. IVA TAX PROPOSAL (PERCENT; BILLIONS OF LIRE)

	OLD		NEW		ADDITIONAL
RATES	REVENUE	RATES	REVENUE		REVENUE
1, 3	590	3	690		100
6, 9	2,490	9	3,465		975
12, 18	5,180	18	6,880		1,700
30, 35	2,450	36	2,880		430
TOTAL QPNUQP			13,915		3,205

5. ESTIMATED MACROECONOMIC EFFECTS OF FISCALIZATION/IVA PROPOSAL WOULD REPORTEDLY BE: (1) RISE OF 3 PERCENT IN PRICES (OF WHICH 1.66 PERCENT FROM SCALA MOBILE), (2) IMPROVEMENT OF 2,000 BILLION LIRE IN BALANCE OF PAYMENTS, AND (3) INCREASE OF 200,000 JOBS.

6. COMMENT. SINCE EMBASSY HAS NOT BEEN ABLE TO OBTAIN DETAILED DATA ON ESTIMATED 1977 CASH BUDGET EXPENDITURES AND ON THE 1977 REVENUE ESTIMATE BASE (I.E., PRIOR TO STABILIZATION MEASURES), IT IS DIFFICULT TO ASSESS ADEQUACY OF TAX MEASURES TAKEN TO DATE. WHILE 5,000 BILLION LIRA PACKAGE IS QUITE SUBSTANTIAL, IT IS NOT DIFFICULT TO IMAGINE THAT GOI MAY HAVE TO FUND NEW PROGRAMS AND ACCUMULATED FINANCING OBLIGATIONS TO THE EXTENT THAT 5,000 BILLION PACKAGE WOULD NOT ALLOW ENOUGH REDUCTION IN 1977 FORECAST CASH BUDGET DEFICIT. UNLESS FINANCING OF CASH BUDGET DEFICIT IS REDUCED SIGNIFICANTLY FROM ORIGINAL FORECAST OF 13,600 BILLION LIRE, SUCH A DEFICIT (ALONG WITH RELEASE OF ABOUT 4,000 BILLION LIRE IN PRIOR EXCHANGE DEPOSITS) COULD CREATE EXCESSIVE AMOUNT OF MONETARY BASE AND BE SERIOUSLY INFLATIONARY.

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7. ADOPTION OF AN IVA TAX INCREASE WILL DEPEND UPON WHETHER BUSINESS AND LABOR OR GOVERNMENT, ITSELF, EVENTUALLY PROPOSE TO REDUCE LABOR COSTS THROUGH SOME FISCALIZATION MEASURE. INCREASE IN INCOME TAX RATES SEEMS RATHER UNLIKELY, ALTHOUGH WZ ONE TIME UNIONS PROPOSED ACROSS-THE-BOARD SURTAX ON BOTH WAGE AND NON-WAGE INCOME AS ALTERNATIVE TO MODIFICATION OF SCALA MOBILE. FINALLY, RESTORATION OF SOME INDEPENDENT TAXING AUTHORITY FOR MUNICIPAL GOVERNMENTS MAY WELL BE PART OF EVENTUAL REFORM OF LOCAL GOVERNMENT FINANCES.VOLPE

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